



April 7, 1967

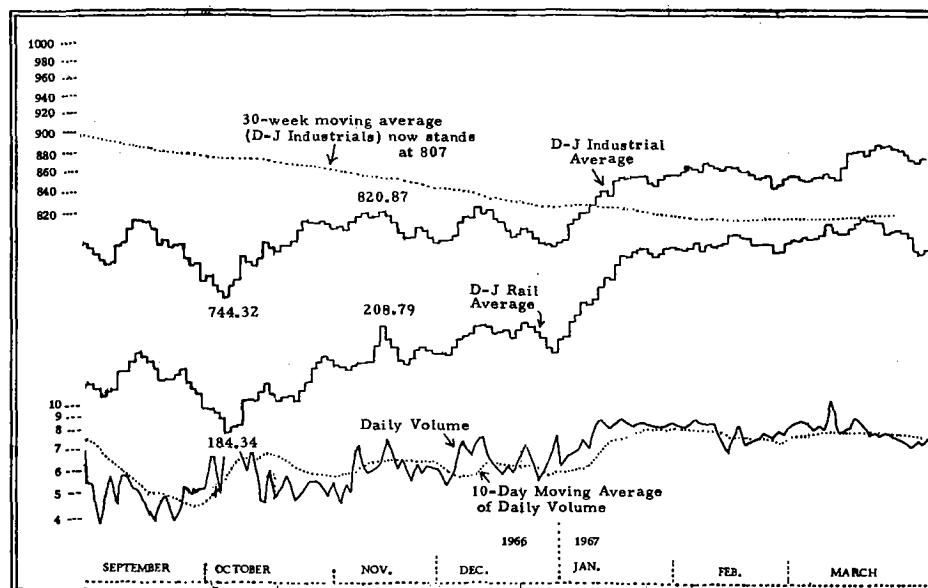
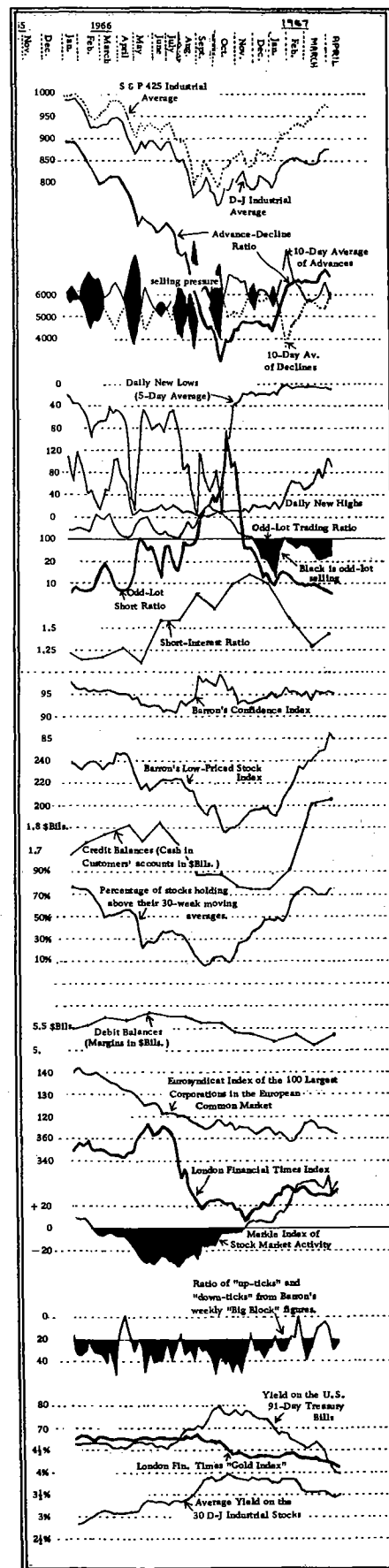
Letter 354

THE MARKET: The pressure of speculative money in the stock market has been enormous. It is conceded now that corporate earnings for the first quarter of 1967 will be worse than expected even as late as a few months ago. In his "Up And Down Wall Street" column in Barron's, Alan Abelson provided some estimates for early 1967 earnings reports. They are hardly heartening reading. "For investors who like to worry about something more tangible than speculative excesses," writes Abelson, "we can recommend up-coming first-quarter earnings reports. The way things look, most companies will report net 10% to 15% below last year's booming three months."

Will the market be surprised by the actual publication of poor earnings for the first quarter? I sincerely doubt it. The news is now publicized, and the word is "be ready for bad news in the first quarter." Obviously, under the pressure of flood-tide money to invest, buyers have been speculating on a second, third or fourth quarter upturn in earnings, with 1968 coming in as if early 1967 was just a bad dream.

From a "reverse-English" standpoint, some analysts are pointing out that a new rise in the economy would not be as bullish as hitherto expected. For if the economy were to start expanding again, they feel that money would quickly tighten in a performance akin to that of a year ago. The possibility was touched upon in the concluding paragraph of the latest Cleveland Trust Company Business Bulletin: "Perhaps the real danger in the outlook for stock prices in 1967 is that corporate profits will not decline after mid year but that business sales will rise strongly after inventory adjustments in the first half and conceivably the same problems of inflation and tight money would return again to haunt the financial community in the last half as occurred during 1966."

Meanwhile, Hamilton Bolton in his latest Bank Credit Analyst bulletin, has published data and a chart depicting the total credit sources and commitments of the U.S. banking system. This chart shows clearly that over the past 50 years there have been only three periods when total bank sources and commitments have dropped into the minus or deficiency column. The three periods were 1918 to 1921, mid-1928 to mid-1932, and the period from June, 1966 to the present. I feel that this chart is extremely significant, since it implies that the banking system is now more vulnerable than any time in the past 35 years. It also suggests the end or near-end of the major



Page 2 cycle, and this picture is backed by Bolton's studies of the velocity of turnover of demand deposit at New York. Here too, we see the velocity rising precipitously to its highest level since 1929, and this is symptomatic of frenzied (really once-a-generation) speculative use of demand deposits. Thus, the monetary picture has assumed a significance unlike anything seen before in this generation.

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The Industrial Average topped out in February, 1966 at 995.15. From that peak it dropped a total of 250.83 points to a low of 744.32 in October, 1966. The major correction which began in October carried to a recent high of 876.67 on March 23, 1967. This represented a total retracement of 52% of the entire 1966 losses. It is interesting to see the Industrial Average hesitating and backing-and-filling in the area of 869.74, which level represents the exact halfway level of the 1966 decline. I have said before that I believe what the Dow does at the halfway level of a previous major rise or decline is extremely important. It is important under Dow's 50% Principle (see Letter 353). A persistent refusal by the Dow to hold decisively above the halfway level of the 1966 decline (869.74) would be bearish and would imply that in time the Averages will decline to test (and probably violate) the 1966 lows. On the other hand, a rise taking the Dow decisively above 869.74 (and it would have to hold persistently above that level) would be bullish under Dow's 50% Principle. Such a move would greatly enhance the possibility of some sort of test of the "above 900" area if not an actual approach to the all-time highs of 995.15 recorded in February, 1966.

On Friday, March 31, the Industrial Average dropped back below 869.74, after holding above the halfway level for the preceding six days. Whether this little decline is significant cannot yet be known. Also worth noting is the fact that volume indications on the N.Y.S.E. changed as the Dow moved into the 869.74 zone. There was not a single day of 10 million shares or over as the Dow climbed over the halfway 869.74 level. Evidently (consciously or unconsciously) investment sentiment turned more conservative as the Dow pushed temporarily over the 50% level. It will take more time to see what all this means, but the importance of the hesitation above 869.74 and the subsequent decline under that level could be significant, particularly if the Dow decides to follow a persistently lower trend from here.

INVESTMENT POLICY: I have received many letters asking for stock selections for investment or speculation. I have also received many inquiries regarding the wisdom of holding Treasury bills in view of their yield decline slightly below the 4% level. I believe that we are in a typically deceptive (second phase) rally within a primary bear market. Such rallies have in the past generally managed to fool just about everyone. Many services are saying that the current rise is discounting a forthcoming upturn in business, but in a primary bear market the rallies are usually technical and (unlike rallies in bull markets) they therefore do provide reliable forecasts of forthcoming turns in business.

I believe that when this rally peters out (and current volume indications suggest that the peak of upside "fever" may have passed), the bear forces will take hold again—perhaps with a suddenness and viciousness which will surprise everybody. Therefore, I continue to warn subscribers against stock purchases which I believe would be executed against the primary trend.

As for Treasury bills, these continue to be the safest harbor for money. True, certificates of deposit of 90 to 180 days may be purchased from good banks, and these will yield around 5%. However, the primary consideration now is safety, and utmost safety is to be obtained from Treasury bills. Therefore, while I do not rule out C/D purchases by knowledgeable investors (from top-rated banks), I feel that the bulk of my subscribers would do best to stay with Treasury bills which are the first call on the assets and taxing power of the U.S. Government.

APOCALYPTIC: The publisher of another advisory service wrote last week and among other things he opined that my viewpoint regarding the market was "apocalyptic." In a sense this is true, and it is based on my attitude or belief about the primary trend. I have written

FROM ALL POINTS: I realize that few readers can afford to subscribe to a large number of leading advisory services. In the past, at varying intervals, I have included "summing up" quotes from important advisory services, and here we go again.

From the Bolton-Tremblay Bank Credit Analyst (just in) "This all adds up to a NEUTRAL rating with a strong probability that we may have to wait many months before the economic air is clear. In the meantime, investors are being given more time to get their houses in order. Subscribers may well want to ponder also the overall grand picture of banking reserve deficiency which puts the U.S. economy in its most vulnerable position since 1929 and 1928. This overall picture makes us skeptical that simple remedies of easy money are the solution to all our ills. Let's wait and see."

From the Drew Odd Lot Studies (April 1): "Longer-term fundamental considerations introduce a dubious element, but it's difficult as yet to see signs of important technical weakness. Selective and rotational strength appears likely to continue over the relatively near term."

From the March 31 Dines Letter "And, as you will see below, technical indicators are still rampantly bullish; even on days when the D-J is down, there is an overwhelmingly larger number of new highs than new lows. We are only introducing an element of caution for the first time, indicating that it is growing late for new commitments."

From the April 1 "Dow Theory Trader" by E. George Schaefer: "At Friday's close. it looked to me as though the nearly 6-month rally since the (1966 lows) was finally beginning to cool off. I do not look for anything big in the upswings during the months ahead. There was little, if any, bullishness in the atmosphere this week. However, we must allow a sufficient amount of time for any downside momentum to develop. A plunge below 827 on any close for the Industrial Average should do it, but since this is a highly speculative, selective, and abnormal market, it may remain so for a while longer, and take its own sweet time. My guess would be that a clearly bearish movement will develop soon."

From the Granville Market Letter (March 31): "My indicators suggest that we are on the edge of a precipice. The Climax Indicator calls for an important downturn to commence sometime between March 23 and April 21."

From the April 3 Tillman Survey: "All in all we think that the market's decline in 1966 discounted poorer business in 1967. Now its rise is discounting better business in 1968. the immediate trend is still up, and any reaction which may follow it will be another buying opportunity."

From Money & Credit Reports by Irving Weiss (March 31): "We believe this is the real potential damage that is going to hit with full force in 1967 and 1968. Many businesses are failing to slash overhead and build cash resources, because they've been encouraged by Washington not only to hold on to their inventories and let their receivables stagnate, but also to further expand their operations. Their number is legion—and their actions are exactly the opposite of the great number of businessmen in 1930 who hopped right to it to clean in house in expectation of further trouble."

often about the primary trend, but very few subscribers seem able to comprehend fully this "mysterious" concept. Perhaps it is because investors are unable to believe in "something they cannot actually see or feel." Also, while the primary concept is a long-term optimistic concept during a bull market, it is conversely a long-term pessimistic concept during a bear market, and hence less appetizing than ever. To believe that the forces of a primary bear market will ultimately express themselves, regardless of what President Johnson, the Fed, the Treasury or anybody else does, is hardly a pleasant thought. Yet that is exactly what I think.

Once a primary bull market hits its final top, the market may be said to have discounted (in the long-term sense) the best that can be seen ahead. From then on, regardless of government stimulants or Presidential pleadings, the overall trend will be down. It will continue down (punctuated by upward corrections and periods of renewed hope) until the bearish forces have fully expressed themselves.

Historically, major bear markets tend to erase half or more of the gains of the previous bull market. Historically, bear markets tend to take a quarter to a third as long as the bull market which preceded them. Since the bull market of 1949-1966 took the Dow from 161.60 to 995.15 (833.15 points), an erasure of half that gain could take the Dow back to 578.37. Such a bear market, if it were to last one quarter to one third as long as the 17 year 1949-1966 rise, could take four or five years. If government applies manipulative measures in an attempt to stem the primary tide, the length and depth of the bear market is most like to be extended. The bear market would be extended because new stimulants mean new excesses, and it is the nature of a bear market to purge excesses from the market and the economy before that bear market reaches conclusion.

But why does a bear market "have to" express itself, I am asked? Why is a modern government not capable of halting the bear forces and insuring the continuation of the bull trend? Why does a bull movement, regardless of its length or extent, have ultimately to undergo a major correction (i.e., a bear market)? These questions represent the essence of the counter-arguments, namely, why is a bear market inevitable, why must every bull market end?

My main comment is that bull and bear markets are evidently fated to occur as long as human nature remains the same. As long as men are adventurous, and as long as adventure turns to speculation and speculation to greed, then the forces of correction will ultimately come to pass, and those forces will tend to purge the market and the economy of the products of greed and speculation. It has been that way since our first records of business and economics. Each decade and each century has brought about new inventions, new methods and new hopes. But human nature has not changed. And it should be remembered that markets and economics are made by the actions and the minds of men. Never in human history has a period of rising hopes, optimism and speculation "grown to the sky." Such periods have always ended with disillusionment and pessimism. When the tide turns, the hopes and speculative dreams come back to earth, and it does not matter whether the hopes were based on the price of tulip bulbs, railroad shares or sophisticated new electronic stocks.

WAR TIDE: Now I want to re-examine a subject which I have talked a good deal about over the past year. This is the war in Vietnam. I have been one of the "big pessimists" on the war, and as veteran subscribers know, I have been steadfastly unimpressed by the rumors, theories and hopes for a quick end to this spreading conflagration. The war in Vietnam is becoming more critical, and it is fast becoming the biggest factor in American thinking, planning and economic forecasting. As Eliot Janeway put it last week, "Nothing that goes on in the economy or in the markets or in Government decision-making about the markets or in politics rates as fundamental. The war is the big imponderable; and the big imponderable is the war." I agree fully.

Few observers realize that the violently nationalistic, extremist forces of Chairman Mao have lost the battle for Chinese leadership. The uproar of Mao's Red Guard has suddenly subsided. The leadership is being taken over by one of the coolest (and canniest) heads in China, Chou En-lai. Chou represents the "progressive" group which wants close relations with Russia, industrialization, compromise with world communism and a move by China into the modernism of the 20th century. That the pro-Chou forces are taking over is the worst possible turn-of-events for the U.S. and the war in Vietnam. For this suggests that the war will go on, and it will continue to expand, that Russian arms will continue to flow, that casualties will continue to mount, and that China will continue to play the waiting game in its long-term (and I mean long-term) battle for Southeast Asia.

The new situation is to Russia's liking, for as long as the war goes on U.S. guns will be turned towards a possible large-scale confrontation with China. The new situation is to China's liking for it means that North Vietnam (without a drop of Chinese blood and with Russian hardware) will be bleeding the U.S. and opening the way for the long-awaited (although patiently awaited) Chinese takeover in Eastern Asia.

So, all in all, I look for an extended, costly war, a war which finds Communism fighting on or near its own territory against a United States which must ship men and goods over thousands of miles in one of the most expensive wars in American history. As a final ominous possibility, I believe that there is a chance during the period ahead of Russia sending in her sophisticated SAM

Page 4 missiles to North Vietnam. If this happens, many experts believe that U.S. air casualties would increase so drastically that the whole bombing offensive would be open to question. All of this the market must take into account as it assesses the bullish or bearish odds for 1967 and thereafter.

BREADTH STUDIES: I have included the excellent weekly breadth chart from Traders Research (1431 Pearl St., Alton, Ill. 62003). It is worth studying carefully at this time. If this were a primary bull market, there would be nothing wrong in the profiles shown on this chart. But the chart becomes more significant during a primary bear market. When a bear market becomes oversold, the bull forces temporarily take over. They bring about the upward corrections prior to a resumption of the primary bear trend. Thus it becomes important during a correction in a bear market to try to identify the area in which the bull forces are ebbing, for when this happens the odds run high that trouble is just around the corner.

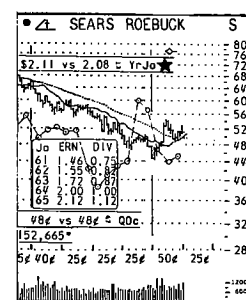
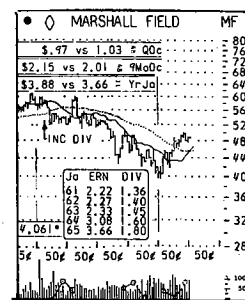
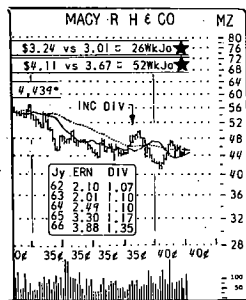
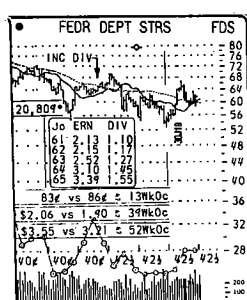
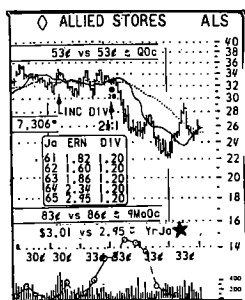
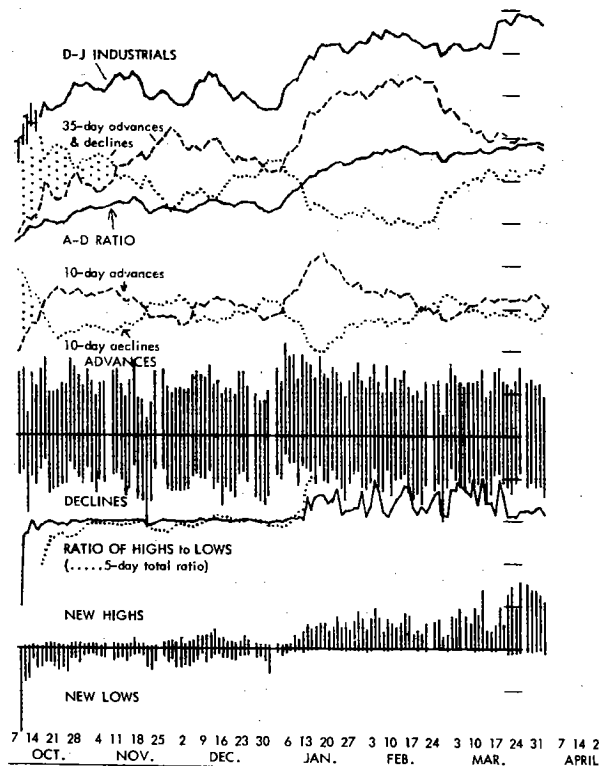
Note the 35-day moving average of advances (dashed line) and declines (dotted line) on the chart. The advances have held generally above declines since late-October, and the peak of strength was seen around the middle of February. Since then, although the Dow has moved slightly above its February (860.97) peak, the advances have been dropping off and declines have been moving up. At the same time, the A-D ratio as shown on this chart has moved almost sideways since mid-February. The new-highs and new-lows were adjusted for the new year in March, but here too there are early signs of new-highs ebbing and new-lows picking up slightly.

If the 35-day breadth averages cross, with declines holding definitely above advances, I would think it would constitute an early sign that the bull forces were definitely losing strength. In that case, I would not rule out another push or two by the Industrial Average (perhaps to new highs), but I would also guess that the next potential rise would be "sloppy" with Rails not confirming or with the A-D ratio failing to make new highs for the move. We will watch this entire picture carefully in the weeks ahead.

RETAIL: One of the so-called "cruxes" of the current economic upturn dilemma is whether the consumer is going to come in and buy, now that the Government has flooded the nation with money. Auto sales are coming into the season where last-year comparisons are going to be more favorable, and I do not rule out a few 10-day periods where sales this year may even go over the comparable 10-day periods of 1966. If so, we can expect an almost hysterical propaganda barrage.

However, I doubt that retail sales are going to recover anywhere near enough to make a "new economic boom" possible. I include charts of a few representative and leading retail organizations listed on the N.Y.S.E. Most of these stocks do not reflect the probability of a new retail or consumer surge, and this should become increasingly significant as the year moves along. For if sales do not pick up substantially, the current huge inventories will prove a continuing depressant to the market and the economy. (Charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas).

BREADTH of MARKET



By the Associated Press

Washington

QUOTE OF THE WEEK:

Federal spending under President Johnson's proposed budget will increase \$38 billion, or 27 percent, in the 1966-68 period, the American Enterprise Institute says.

The institute says federal domestic nondefense spending will be up 26 percent in fiscal 1968 compared with actual 1966 outlays, while defense costs, including the Vietnamese war, will rise by 31 percent.